

Message Text

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ACTION ARA-14

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SUBJECT: SELECTED MODIFICATIONS IN BRAZILIAN EXPORT INCENTIVES

1. SUMMARY. IN RECENT MONTHS THE GOB MODIFIED THE FISCAL INCENTIVES FOR EXPORTERS BY SHIFTING FROM THE STATES TO THE FEDERAL GOVERNMENT THE RESPONSIBILITY FOR TAX CREDITS GRANTED BY INDIVIDUAL STATES AND BY ANNOUNCING ELIMINATION OF THE TRANSFER OF TAX CREDITS BY EXPORTERS TO DOMESTIC SUPPLIERS. FINANCE MINISTRY OFFICIALS HAVE EXPLAINED THAT ACCEPTANCE IN PRINCIPLE OF ALL TAX CREDITS BY THE GOB IS AIMED AT RELIEVING PART OF FISCAL BURDEN ON STATES RESULTING FROM EXPORT PROMOTION. GOB AND PRIVATE EXPORTERS MAINTAIN THAT THE SHIFT IS NOT EXPECTED TO EFFECTIVELY INCREASE EXPORT

INCENTIVES AND THAT THE ABILITY OF EXPORTERS TO UTILIZE TAX CREDITS HAS NOT IMPROVED. SPECIFICALLY, EXPORTERS CANNOT EASILY CONVERT TAX CREDITS TO CASH WITH THE GOB AND PRIVATE SECONDARY MARKTS IN TAX CREDITS ARE EXPLICITELY PROHIBITED. THE ELIMINATION OF THE OPTION TO TRANSFER TAX CREDITS TO SUPPLIERS REDUCES THE EFFECTIVE EXPORT INCENTIVE. END SUMMARY.

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2. IN JANUARY 1978 THE GOB ANNOUNCED THAT HENCEFORTH THE FEDERAL GOVERNMENT WILL ASSUME RESPONSIBILITY FOR REIMBURSING EXPORTERS EARNING TAX CREDITS EQUIVALENT TO THE AMOUNT OF TAX LIABILITY THEY WOULD INCUR UNDER THE STATE ICM TAXES IN THE ABSENCE OF THE EXPORT INCENTIVES. EXPORTS WILL CONTINUE TO BE EXEMPTED FROM STATE ICM TAXES AND FROM THE FEDERAL IPI TAX AND THEY WILL CONTINUE TO RECEIVE IPI TAX CREDITS UP TO A LIMIT OF 15 PERCENT. THEY WILL

ALSO CONTINUE TO RECEIVE THE TAX CREDIT DETERMINED BY THEIR ICM TAX LIABILITY UP TO A LIMIT OF 13 PERCENT BUT THE FEDERAL GOVERNMENT RATHER THAN STATES WILL BE THE RECIPIENT OF THE ICM TAX CREDITS. THE OBJECTIVE OF THIS SHIFT OF ICM TAX CREDIT RESPONSIBILITY TO THE GOB IS TO RELIEVE THE STATES OF PART OF THE FINANCIAL BURDEN RESULTING FROM THE FISCAL INCENTIVES FOR EXPORT. SEVERAL STATES, INCLUDING, IN PARTICULAR, PARANA, HAVE EXPERIENCED FINANCIAL DIFFICULTIES IN RECENT YEARS IN PART BECAUSE OF FOREGONE TAX REVENUES RELATED TO TAX EXEMPTIONS AND CREDITS FOR EXPORTERS.

. IN FEBRUARY THE GOB ANNOUNCED ELIMINATION OF THE ABILITY OF EXPORTERS TO TRANSFER TO DOMESTIC SUPPLIERS ANY TAX CREDITS, RELATED EITHER TO THE ICM TAX OR THE IPI TAX. THIS OPTION WAS IMPORTANT TO PRODUCERS WHO EXPORT A LARGE PROPORTION OF THEIR TOTAL OUTPUT AND THUS EARNED TAX CREDITS IN EXCESS OF THEIR TAX LIABILITIES ON OUTPUT FOR INTERNAL SALE. THE PRACTICE HAS CONSISTED OF SELLING THE TAX CREDITS TO SUPPLIERS IN RETURN FOR INPUTS, USUALLY AT 10-15 PERCENT DISCOUNT BECAUSE THE SUPPLIERS ARE NOT ABLE TO USE THE NON-INDEXED TAX CREDITS UNTIL AFTER A DELAY OF 150 DAYS. THE MOTIVE FOR THIS CHANGE IN THE EXPORT FISCAL INCENTIVES HAS NOT BEEN FULLY EXPLAINED BY THE GOB. HOWEVER, FINANCE MINISTRY BUREAUCRATS AND EXPORTERS HAVE COMMUNICATED TO EMBASSY OFFICERS THAT THE OBJECTIVE WAS TO PRECLUDE FRAUDULENT USE OF THE OPTION. THEY HAVE SUGGESTED THAT THE GOB HAS UNCOVERED SPECIFIC CASES WHERE EXPORTERS ABUSED THE LEGAL PROVISIONS BY TRANSFERRING TAX CREDITS TO ENTITIES AND PERSONS THAT DID NOT QUALIFY AS LIMITED OFFICIAL USE

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SUPPLIERS, TO THE EXPORTING FIRM. DUE TO EXPORTERS' PROTESTS, THE GOB IN APRIL RESTORED THE POSSIBILITY OF EXPORTERS SELLING TAX CREDITS TO SUPPLIERS BUT THE NEW MEASURE IS ONLY TEMPORARY AND ELIMINATION OF TAX CREDIT TRANSFERS TO SUPPLIERS WILL TAKE EFFECT AGAIN AT THE END OF JULY.

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4. AS OF AUGUST 1 THEREFORE EXPORTERS WILL RECEIVE IPI AND ICM TAX CREDITS FROM THE GOB WHICH CAN BE APPLIED AGAINST IPI TAX LIABILITIES, TRANSFERRED TO COMPANIES DIRECTLY RELATED TO THE EXPORTING FIRM, OR CONVERTED INTO CASH BY THE GOB. FINANCE MINISTRY OFFICIALS HAVE EXPLAINED TO FINATT (AND VISITING TREASURY OFFICER, JEFF SCHOTT) THAT THE LATTER METHOD OF UTILIZING TAX CREDITS HAS NOT BEEN ALTERED AND REMAINS SUBJECT TO CONSIDERABLE DELAYS AND POTENTIAL LOSSES DUE TO TIGHT ADMINISTRATIVE CONTROLS. SOME EXPORTERS HAVE INDICATED TO CONSULAR OFFICERS IN SAO PAULO THAT IN PRACTICE CERTAIN STATE GOVERNMENTS HAVE MADE THE CONVERSION OF ICM TAX CREDITS EXTREMELY COMPLICATED AND BURDENSOME. THE FINANCE MINISTRY SPOKESMEN ACKNOWLEDGED THAT STATES SOMETIMES HAVE BEEN VERY CONSERVATIVE AND THAT SHIFTING OF THE ICM TAX CREDIT REIMBURSEMENT TO THE GOB MAY FACILITATE THE PROCESS SOMEWHAT. HOWEVER, THEY EMPHASIZED THAT THE GOB ALSO REQUIRES EXTENSIVE DOCUMENTATION PROVING THAT THE EXPORTING FIRM HAS EXHAUSTED ITS POTENTIAL UTILIZATION OF TAX CREDITS FOR MEETING TAX LIABILITIES BEFORE CONVERSION TO CASH IS PERMITTED. THEY COMMENTED THAT MANY FIRMS-- ESPECIALLY SMALL AND MEDIUM-SIZED EXPORTERS--LACK THE STAFF AND/OR THE INCENTIVE TO UNDERTAKE THE RED TAPE INVOLVED. AT LEAST ONE FACTOR IS THE RISK OF SUBSTANTIAL PENALTIES IF THE REQUIRED

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DETAILED ACCOUNTING REVEALS THAT A COMPANY HAS BEEN DEFICIENT IN ITS PAYMENT OF TAXES.

5. THE FINANCE MINISTRY OFFICERS CLAIMED THAT BECAUSE OF THE DELAYS AND DISINCENTIVES MANY EXPORTERS CHOOSE TO CARRY OVER TAX CREDITS INTO A NEW TAX YEAR RATHER THAN ATTEMPT TO CASH THEM IN. THEY STATED, HOWEVER, THAT THE GOB DOES NOT HAVE STATISTICAL INFORMATION ON THE AMOUNTS OF TAX CREDITS ISSUED AND THE PROPORTIONS THAT ARE USED TO MEET TAX LIABILITIES, THAT ARE TRANSFERRED TO RELATED COMPANIES AND SUPPLIERS, AND FINALLY THAT ARE CONVERTED TO CASH. THEY MAINTAIN THAT SUCH DATA ARE AVAILABLE ONLY BY MEANS OF SPECIFIC INDUSTRY SURVEYS. IN RESPONSE TO QUESTIONING, FINANCE MINISTRY SPOKESMEN HAVE INDICATED EXPLICITLY TO FINATT THAT EXPORTERS

CANNOT REPEAT CANNOT SELL THEIR TAX CREDITS FREELY. THE GOB REPORTEDLY CONSIDERED SOME YEARS AGO THE IDEA OF CREATING A

SECONDARY MARKET IN TAX CREDITS THAT COULD BE BOUGHT AND SOLD AT A DISCOUNT RELATED TO THEIR MATURITY. HOWEVER, THE GOB DECIDED NOT TO ADOPT SUCH A SYSTEM AND INSTEAD CREATED THE EXISTING LIMITED AND CLOSELY CONTROLLED OPTIONAL USES OF TAX CREDITS. THE MOVE TO ELIMINATE

TRANSFER OF TAX CREDITS TO SUPPLIERS CAN BE INTERPRETED AS A TIGHTENING OF THE CONTROLS IN THIS REGARD.

6. EXPORTERS' RESPONSES TO EMBASSY/CONSULATE INQUIRIES HAVE INDICATED THAT MANY ARE UNAWARE OF THE DETAILS OF THE SHIFT OF THE ICM TAX CREDIT TO THE GOB AND THAT IN GENERAL THEY DO NOT ANTICIPATE ANY BENEFITS TO RESULT FROM THE MEASURE. A FEW LARGE FIRMS FEEL THEY MAY BE ABLE TO REDUCE RED TAPE AND ADMINISTRATIVE COSTS AND TO EFFECTIVELY UTILIZE WHAT WERE PREVIOUSLY EXCESS ICM TAX CREDITS. HOWEVER, NEITHER THE EXPORTERS NOR THE GOB SEEM TO HAVE ANY IDEA WHAT THE QUANTITATIVE IMPACT MAY BE. GOB SPOKESMEN, OF COURSE, HAVE POINTED OUT THE EMBASSY THAT: 1) LIMITED OFFICIAL USE

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TAX CREDITS THEMSELVES ARE SUBJECT TO INCOME TAX; 2) THAT THE EXPORT FISCAL BURDEN SHIFT FROM THE STATES TO THE GOB IS NOT RELEVANT TO EXPORTS OF SHOES BECAUSE THE ICM CREDIT ON SHOES WAS ELIMINATED IN ACCORDANCE WITH SIMON-SIMONSEN AGREEMENT OF MAY 1976.

7. COMMENT. UTILIZATION OF ICM TAX CREDITS BY SOME EXPORTERS MAY INCREASE marginally DUE TO DIFFERENCES BETWEEN THE ADMINISTRATIVE OBSTACLES PREVIOUSLY RAISED BY THE STATES AS COMPARED TO THE REQUIREMENTS OF THE GOB WITH RESPECT TO CONVERSION. ON THE OTHER HAND, SUCH CONVERSION REMAINS COMPLICATED AND DIFFICULT AND REQUIRES PRIOR EXHAUSTION OF THE OTHER MEANS OF TAX CREDIT UTILIZATION. MOREOVER, THE GOB CLEARLY HAS NOT MOVED TOWARD PERMITTING FREE CONVERSION OR TRANSFER OF TAX CREDITS IN THE MARKET PLACE; ON THE CONTRARY, IT HAS REDUCED THE ABILITY OF THE EXPORTER TO TRANSFER THE TAX CREDITS. ON THE BASIS OF THE INFORMATION AVAILABLE AT THIS TIME, THE EMBASSY THEREFORE CONCLUDES THAT THE RECENT MODIFICATIONS OF BRAZIL'S TAX INCENTIVES FOR EXPORTS ARE AIMED MAINLY AT ALTERING THE DISTRIBUTION OF THE FISCAL BURDEN AND TIGHTENING ADMINISTRATIVE CONTROLS AND ARE NOT EXPECTED TO RESULT IN ANY SIGNIFICANT INCREASE IN EFFECTIVE SUBSIDIZATION OF BRAZIL'S EXPORTS. JOHNSON

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